

## Unit Assessment

Illinois Consolidated Revenue Act of 1872 (135 years ago)

Upheld by Supreme Court in *State Railroad Tax Cases* in 1875, where the court stated that the theory of the approach was "manifestly to treat the railroad track, its rolling-stock, its franchise, and its capital, as a *unit* for taxation." 92 U.S. at 602. Hence "unit" approach.

### 100 % Stock and Debt

Intangibles (stocks, mortgages, commercial paper) were taxable (I'll discuss later how intangibles came to be exempt and which intangibles)

Cost approach was there, but not very sophisticated. Original cost, generally not depreciated. Accounting as a science was not well developed at the time and generally didn't develop until post-1933 creation of SEC.

No income approach at the time (discounting to present value not developed).

Income taxes did not really exist (16<sup>th</sup> Amendment dates to 1913).

Unit Assessment progressed from RR's to Western Union to Pullman Car Co. to Express Companies

Canadian assessment officials call these "linear properties"

Note, however, that there is a subtle shift here:

Pullman Car Co. was just a group of rail cars. They didn't own the depots, track structure, engines, or manage RR staff. They didn't have property that stayed permanently tied together. Still taxed as a unit and at a value different from the Pullman cars alone. (1891)

Issue came to a head in *Adams Express v. Ohio State Auditor*. Horse and wagon express companies, including American Express. Describe. The gap in the middle was the RR. 1897 the U.S. Supreme Court said that they could be taxed as a unit.

Now, whenever separate articles of tangible property are joined together, not simply by a unity of ownership, but in a unity of use, there is not infrequently developed a property, intangible though it may be, which in value exceeds the aggregate of the value of the separate pieces of tangible property. Upon what theory of substantial right can it be adjudged that the value of this intangible property must be excluded from the tax lists, and the only property placed thereon be the separate pieces of tangible property?

Doubtless there is a distinction between the property of railroad and telegraph companies and that of express companies. The physical unity existing in the former is lacking in the latter; but there is the same unity in the use of the entire property for the specific purpose, and there are the same elements of value arising from such use. The cars of the Pullman Company did not constitute a physical unity, and their value as separate cars did not bear a direct relation to the valuation which was sustained in that case. The cars were moved by railway carriers under contract, and the taxation of the corporation in Pennsylvania was sustained on the theory that the whole property of the company might be regarded as a unit plant, with a unit value, a proportionate part of which value might be reached by the state authorities on the basis indicated. \*\*\* The unit is a unit of use and management. \*\*\* We repeat that, while the unity which exists may not be a physical unity, it is something more than a mere unity of ownership. It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case,-resulting from the very nature of the business.

This case then becomes the settled law of the land. It is the classic case of unit assessment and cited in every precedent setting state unit assessment case to follow. Cf. 15-23-301 Assessment of Public Utilities enacted in 1919.

**15-23-301. Officers of certain public utility companies to furnish statement to department.** The president, secretary, or managing agent or such other officer as the department of revenue may designate of any corporation and each person or association of persons owning or operating a telegraph, telephone, microwave, electric power, or transmission line, natural gas pipeline, oil pipeline, canal, ditch, flume, or other property, other than real estate not included in right-of-way, **and which constitute a single and continuous property throughout more than one county or state,** must each year furnish the department a statement, signed and sworn to by one of such officers or by the person or one of the persons forming such association, showing in detail for the year ending on December 31 immediately preceding as follows:

(1) the whole number of miles of said property in the state and, where the property is partly out of the state, the whole number of miles without the state and the whole number of miles within the state owned or operated by such corporation, person, or association;

(2) the total value of the entire property and plant, both within and without the state, and the total value of that portion of the same within the state;

(3) a complete description of the property within the state, giving the points of entrance into and the points of exit from the state and the points of entrance into and the points of exit from each county, with a statement of the total number of miles in each county in the state;

(4) such other information regarding such property as may be required by the department.

Thus, when you are considering the meaning of "single and continuous", you need to know that *Adams Express* was a well established feature of the landscape when Montana enacted this statute. All this was confirmed in *Western Union* (1932) case in Montana. No physical connection between Montana cables and undersea cables. Montana portion of WU unit was \$1MM without undersea cables in unit and was \$1.2 MM with undersea cables in unit.

The whole transaction from the acceptance of messages in Montana to and including the transmission thereof over its cables is a single and continuous transaction of plaintiff in the conduct of its general business, **and the fact that there is no physical connection between the land lines and the ocean cables is of no consequence.**

The Montana Supreme Court cites to *Adams Express* and upholds Department's unit taxing WU at the \$1.2 MM.

Recap so far:

1. 19<sup>th</sup> Century development of stock and debt assessment (called unit assessment) and it fit in the context of the times.
2. Physical unity was abandoned as a criteria prior to the turn of 20<sup>th</sup> Century
3. Montana law on unit assessment follows these developments.

A few items concerning mythology of unit assessment worthy of mention at this point before proceeding forward on a brief overview of methodology:

1. Corporate unitary income taxation developed from *Adams Express* and not vice versa.
2. Not an income tax. Even when you are generating loss carry forwards, your property still has value.
3. Accounting explanation that stock and debt is just a surrogate for asset valuation has it directly backwards.
4. None of these companies were regulated when unit assessment arose. (Hope and Bluefield date to 1920's)
5. Intangibles were fully taxable at time of inception of unit valuation. When intangibles exemptions cropped up, the goal was to prevent multiple layers of taxation (i.e., fee simple taxation of real estate, taxation of the mortgage, and taxation of the bank stock led to multiple levels of taxation.)
6. Deliberate expansion of intangibles exemption by centrally assessed companies in 90's to gut assessment of companies large enough to hire an imaginative appraiser. There is no limit to what can be labeled

"intangible" in the valuation of a business. Cf. Montana only intangible personal property exempt, and limited by regulation to specified percentages with high burden of proof on excess.

#### Cost Approach

When audited financial statements became available post 1933, then a cost approach arose. Rate regulation for some of these companies set up OCLD assessment because that was close to regulatory theory.

#### Income Approach

Income approach developed as a market multiple and then as Sharpe and Lintner's CAPM allowed explicit cash flow discounting it became more significant but generally not until 1950s and 1960's.

#### Correlation

All three approaches are significant and may (must) be used as appropriate.  
*Albright*

#### Apportionment:

After the unit is determined, the value must be apportioned to Montana and allocated within Montana.

The apportionment process is very much like apportioning corporate income to Montana for income tax purposes. (Three factor, property, sales, employees)

There are infinite possibilities and there are only a couple of rules  
Multiple factors are good  
Consistency is good

When someone points at a building, or a mile of RR track, or a telephone pole there isn't any necessary correlation between the tax value of the building, mile or pole and its value as a building, mile or pole.